

Notice of Proposed Emergency Action
The California Department of Tax and Fee Administration
Has Adopted California Code of Regulations, Title 18,
Section 3701, *Collection and Remittance of the Cannabis Excise Tax*

NOTICE IS HEREBY GIVEN that the California Department of Tax and Fee Administration (Department), pursuant to the authority vested in the Department pursuant to Revenue and Taxation Code (RTC) section 34013,¹ has adopted California Code of Regulations, title 18, section (Regulation or Reg.) 3701, *Collection and Remittance of the Cannabis Excise Tax*, as an emergency regulation in accordance with Government Code (GC) section 11346.1, to be codified in chapter 8.7, Cannabis Tax Regulations, in division 2 of title 18 of the California Code of Regulations. Regulation 3701 implements, interprets, and makes specific RTC sections 34011 and 34015, which apply to the imposition, collection, reporting, and remittance of the cannabis excise tax imposed by part 14.5, Cannabis Taxes, (commencing with section 34010) of division 2 of the RTC, as added by the voters' approval of Proposition 64 (Prop. 64) on November 8, 2016, and amended by Senate Bill No. (SB) 94 (Stats. 2017, ch. 27) and Assembly Bill No. (AB) 133 (Stats. 2017, ch. 253), which is commonly referred to as the Cannabis Tax Law (CTL).²

EMERGENCY

Statement of Emergency

RTC section 34013, subdivisions (a) and (b), require the Department to administer and collect the cannabis excise and cultivation taxes imposed by the CTL and authorize the Department to prescribe, adopt, and enforce regulations relating to the administration and enforcement of the cannabis taxes. RTC section 34013, subdivision (d), also authorizes the Department to prescribe, adopt, and enforce any emergency regulations that are necessary to implement, administer, and enforce its duties under the CTL. And, it provides that, for purposes of chapter 3.5 (commencing with section 11340) of part 1 of division 3 of title 2 of the GC, including section 11349.6, the adoption of such a regulation "is an emergency and shall be considered by the Office of Administrative Law as necessary for the immediate preservation of the public peace, health and safety, and general welfare."

Section 48 Statement

GC section 11346.1, subdivision (a)(2), requires that, at least five working days prior to submission of the proposed emergency regulation to the Office of Administrative Law, the

¹ Assembly Bill No. 102 (Stats. 2017, ch. 16) established the California Department of Tax and Fee Administration and transferred the State Board of Equalization's (Board's) duties, powers and responsibilities under RTC section 34013 to the Department, effective July 1, 2017. (Gov. Code, §§ 15570, 15570.22.)

² Pursuant to GC section 15570.24 and RTC section 20.5, the references to the Board in the CTL refer to the Department.

Department provide a notice of the proposed emergency action to every person who has filed a request for notice of regulatory action with the Department. After submission of the proposed emergency regulation to the Office of Administrative Law, the Office of Administrative Law shall allow interested persons five calendar days to submit comments on the proposed emergency regulation as set forth in GC section 11349.6.

AUTHORITY

RTC section 34013

REFERENCE

RTC sections 34011 and 34015

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Summary of Existing Laws and Regulations

On November 8, 2016, California voters approved Prop. 64, “the Control, Regulate and Tax Adult Use of Marijuana Act (‘the Adult Use of Marijuana Act’)” (AUMA) (Prop. 64, § 1), which added the CTL to the RTC to impose marijuana excise and cultivation taxes, effective January 1, 2018. As relevant here, Prop. 64 imposed the marijuana excise tax “upon purchasers of marijuana or marijuana products sold in this state at the rate of 15 percent of the gross receipts of any retail sale by a dispensary or other person required to be licensed pursuant to Chapter 3.5 (commencing with Section 19300) of Division 8 of the Business and Professions Code or a retailer, microbusiness, nonprofit, or other person required to be licensed pursuant to Division 10 (commencing with Section 26000) of the Business and Professions Code to sell marijuana and marijuana products directly to a purchaser” (specified seller). (RTC, § 34011, subd. (a), as enacted by Prop. 64, § 7.1.) Prop. 64 made a specified seller “responsible for collecting this tax [from the purchaser] and remitting it to the [Department] in accordance with rules and regulations adopted by the [Department].” (RTC, § 34011, subd. (c), as enacted by Prop. 64, § 7.1.) And, Prop. 64 provided that “No marijuana or marijuana products may be sold to a purchaser unless the excise tax required by law has been paid by the purchaser at the time of sale.” (RTC, § 34011, subd. (f), as enacted by Prop. 64, § 7.1.)

In 2017, the Legislature enacted SB 94 (Stats. 2017, ch. 27), which eased and streamlined the collection and remittance of the cannabis excise tax to the Department. As relevant here, SB 94 repealed chapter 3.5 (commencing with section 19300) of division 8 of the Business and Professions Code (BPC). (SB 94, § 2.) SB 94 replaced the references to “marijuana” with references to “cannabis” throughout the CTL. (SB 94, §§ 161-164, 166-172.) SB 94 revised the renamed “cannabis excise tax” so that it is imposed upon “purchasers of cannabis and cannabis products sold in this state at the rate of 15 percent of the average market price of any retail sale by a cannabis retailer,” instead of the retail selling price of marijuana or marijuana products sold by a specified seller. (RTC, § 34011, subd. (a), as amended by SB 94, § 163.) SB 94 also amended RTC section 34011, subdivision (b), to provide that:

(1) A distributor in an arm's length transaction shall collect the cannabis excise tax from the cannabis retailer on or before 90 days after the sale or transfer of cannabis or cannabis product to the cannabis retailer. A distributor in a nonarm's length transaction shall collect the cannabis excise tax from the cannabis retailer on or before 90 days after the sale or transfer of cannabis or cannabis product to the cannabis retailer, or at the time of retail sale by the cannabis retailer, whichever is earlier. A distributor shall report and remit the cannabis excise tax to the [Department] pursuant to Section 34015. A cannabis retailer shall be responsible for collecting the cannabis excise tax from the purchaser and remitting the cannabis excise tax to the distributor in accordance with rules and procedures established under law and any regulations adopted by the [Department].

(2) A distributor shall provide an invoice, receipt, or other similar document to the cannabis retailer that identifies the licensee receiving the product, the distributor from which the product originates, including the associated unique identifier, the amount of cannabis excise tax, and any other information deemed necessary by the department. The department may authorize other forms of documentation under this paragraph. (SB 94, § 163.)

Also, SB 94 amended the CTL to define the term "cannabis retailer" to "mean a person required to be licensed as a retailer, microbusiness, or nonprofit pursuant to Division 10 (commencing with Section 26000) of the Business and Professions Code." (RTC, § 34010, subd. (j), as amended by SB 94, § 162.) SB 94 amended the CTL to define the term "distributor" to "mean a person required to be licensed as a distributor pursuant to Division 10 (commencing with Section 26000) of the Business and Professions Code." (RTC, § 34010, subd. (l), as amended by SB 94, § 162.) And, SB 94 amended the CTL to provide that "[u]nless otherwise prescribed by the [Department], the excise tax . . . is due and payable to the [Department] quarterly on or before the last day of the month following each quarterly period of three months. On or before the last day of the month following each quarterly period, a return for the preceding quarterly period shall be filed with the [Department] by each distributor using electronic media." (RTC, § 34015, subd. (a), as amended by SB 94, § 168.)

In addition, the Department has separately adopted Regulation 3700, *Cannabis Excise and Cultivation Taxes*, as an emergency regulation, although it has not been approved by the Office of Administrative Law or filed with the Secretary of State yet.³ As relevant here, Regulation 3700, subdivision (a)(4), further defines the term "distributor" to include "a microbusiness that acts as a licensed distributor as set forth in paragraph (3) of subdivision (a) of section 26070 of the Business and Professions Code." And, Regulation 3700, subdivision (e), further clarifies the statutory requirements for distributors to report and remit the cannabis excise taxes they collect from cannabis retailers, and provides that "[a] distributor shall report and remit the cannabis excise tax due with the return for the quarterly period in which the distributor sells or transfers the cannabis or cannabis products to a cannabis retailer."

³ The notice of proposed emergency action for the adoption of Regulation 3700 contains additional background information about the cannabis excise and cultivation taxes and it is available on the Department's website at <http://cdtfa.ca.gov/formspubs/Reg3700-Notice-2017.pdf>.

Furthermore, the Bureau of Cannabis Control (Bureau) within the Department of Consumer Affairs has the sole authority to issue licenses for the distribution and sale of cannabis and cannabis products in this state. (BPC, § 26012, subd. (a)(1).) The Bureau is not required to begin issuing licenses to distributors or cannabis retailers until January 1, 2018. (BPC, § 26012, subd. (d).) The Bureau’s website indicates that the “Bureau intends to start issuing temporary licenses [under division 10 (commencing with section 26000) of the BPC] January 1, 2018.”⁴ And, the Department understands that no person will be required to be licensed by the Bureau as a distributor pursuant to division 10 of the BPC until January 1, 2018. So, there will not be any distributors, as defined in RTC section 34010, subdivision (l), until January 1, 2018. Also, “[e]very person engaged in the business of selling . . . tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax . . . is required to hold a seller’s permit for each place of business in this state at which transactions relating to sales are customarily negotiated with his or her customers.” (Reg. 1699, subd. (a).) And, the Department understands that an applicant for a license issued pursuant to division 10 of the BPC is generally required to “[p]rovide the applicant’s valid seller’s permit number . . . or indicate that the applicant is currently applying for a seller’s permit.” (BPC, § 26051.5, subd. (a)(6).) However, there may be licensed distributors that do not make sales of tangible personal property and are not required to hold a seller’s permit.

Effect, Objective, and Benefits of Emergency Regulation 3701

The Department has determined that RTC section 34011, subdivision (a), imposes the cannabis excise tax on all purchasers of cannabis or cannabis products sold in any retail sale in this state by a cannabis retailer on or after January 1, 2018. The Department has determined that RTC section 34011, subdivision (b)(1), makes a cannabis retailer responsible for collecting the excise tax from the purchaser on all of the cannabis retailer’s retail sales of cannabis or cannabis products on or after January 1, 2018, and remitting the excise tax to a distributor, so that the distributor can report and pay the tax to the Department. This determination is based on the express language of subdivision (b)(1) (quoted above), the provisions of RTC section 34011, subdivision (e), which expressly prohibit a cannabis retailer from making retail sales of cannabis or cannabis products on or after January 1, 2018, unless the excise tax has been paid to the retailer by the purchaser at the time of the sale, and the absence of statutory provisions that would require or permit a cannabis retailer to remit excise taxes directly to the Department. The Department has also determined that when a cannabis retailer purchases or acquires cannabis or cannabis products from a distributor on or after January 1, 2018, then RTC section 34011, subdivision (b)(1), clearly requires the retailer to remit the excise taxes collected on the retail sale of that cannabis or those cannabis products to that distributor, and also requires that distributor to collect those excise taxes from the cannabis retailer and report and remit them to the Department in accordance with RTC section 34015, subdivision (a), and Regulation 3700, subdivision (e).

However, some cannabis retailers will have possession or control of an inventory of cannabis, cannabis products, or both on January 1, 2018, which was not purchased or acquired from a distributor, as defined in RTC section 34010, subdivision (l). There is an issue because it is not

⁴ <http://bcc.ca.gov/licensees/index.html>.

clear how or when those cannabis retailers will remit the cannabis excise taxes collected on their retail sales of cannabis and cannabis products from inventory acquired prior to January 1, 2018. And, the Department has determined that it is necessary to address this issue through the adoption of an emergency regulation before the cannabis excise is effective January 1, 2018. Therefore, the Department drafted Regulation 3701 to have the effect and accomplish the objective of addressing the issue by:

- Incorporating the provisions of RTC section 34011, subdivision (e), which expressly prohibit a cannabis retailer from making retail sales of cannabis or cannabis products on or after January 1, 2018, including inventory acquired prior to January 1, 2018, unless the excise tax has been paid to the retailer by the purchaser at the time of the sale;
- Clarifying that when a distributor sells or transfers cannabis or cannabis product to a cannabis retailer on or after January 1, 2018, then the retailer shall remit the cannabis excise tax due on the retail sale of the cannabis or cannabis product to the distributor that sold or transferred the cannabis or cannabis product to the retailer in accordance with RTC section 34011, subdivision (b)(1) (quoted above);
- Clarifying that when a cannabis retailer makes retail sales of cannabis and cannabis products acquired prior to January 1, 2018, which is possessed or controlled by the cannabis retailer at 12:01 am on January 1, 2018, the cannabis retailer is required to remit the excise tax due to a licensed distributor that the retailer purchased or acquired cannabis or cannabis product from on or after January 1, 2018, on or before the fifteenth day of the calendar month following the close of the calendar month in which the tax was collected by the cannabis retailer;
- Prescribing the invoice, receipt, or similar document that a distributor is required to provide to a cannabis retailer when collecting excise tax due on cannabis and cannabis products acquired prior to January 1, 2018, and requiring it to include the date of execution, name of the distributor, name of the retailer, amount of cannabis excise tax paid, the retailer's seller's permit number, and either the distributor's seller's permit number or a statement that the distributor is not required to hold a seller's permit because the distributor makes no sales, in accordance with the authority granted to the Department in RTC section 34011, subdivision (b)(2) (quoted above); and
- Clarifying that a distributor is generally required to report and remit the excise taxes it collects from cannabis retailers in accordance with Regulation 3700, subdivision (e), but a distributor is required to report and remit the cannabis excise taxes collected on retail sales of cannabis and cannabis products acquired by cannabis retailers prior to January 1, 2018, with the distributor's first return subsequent to receiving the cannabis excise tax from the cannabis retailer.

The Department adopted Regulation 3701, as an emergency regulation, because the Department determined that the adoption of Regulation 3700 is necessary to have the effect and accomplish the objective of addressing the issue discussed above by specifying how and when cannabis retailers are required to remit the cannabis excise taxes collected on their retail sales of cannabis and cannabis products from inventory acquired prior to January 1, 2018, and how distributors are required to report and remit those cannabis excise taxes to the Department, before the cannabis excise tax is effective January 1, 2018. The Department also determined that it is necessary for Regulation 3701 to duplicate provisions from RTC section 34011 to provide clarity.

The Department anticipates that the adoption of emergency Regulation 3701 will promote fairness and benefit distributors, cannabis retailers, and the Department by clarifying how and when cannabis retailers are required to remit the cannabis excise taxes collected on their retail sales of cannabis and cannabis products from inventory acquired prior to January 1, 2018, and how distributors are required to report and remit those cannabis excise taxes to the Department.

The Department has performed an evaluation of whether emergency Regulation 3701 is inconsistent or incompatible with existing state regulations and determined that the emergency regulation is not inconsistent or incompatible with existing state regulations. This is because Regulation 3700 is the only other cannabis excise tax regulation and Regulation 3701 is not inconsistent or incompatible with Regulation 3700. In addition, the Department has determined that there are no comparable federal regulations or statutes to emergency Regulation 3701.

NO DOCUMENTS RELIED UPON

The Department relied on Department staff's understanding of the CTL, division 10 of the BPC, and the cannabis industry in determining that the adoption of proposed emergency Regulation 3701 is necessary to have the effect and accomplish the objective of addressing the issue with the cannabis excise tax discussed above before the cannabis excise tax is effective January 1, 2018. The Department did not rely upon any technical, theoretical, or empirical study, report or similar document in making that determination.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Department has determined that the adoption of proposed emergency Regulation 3701 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the GC.

ONE-TIME COST TO THE DEPARTMENT, BUT NO OTHER COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Department has determined that the adoption of proposed emergency Regulation 3701 will result in an absorbable \$396 one-time cost for the Department to update its website after the emergency rulemaking process is completed (assuming that average hourly compensation costs are \$49.48 per hour and that it will take approximately eight hours). The Department has determined that the adoption of proposed emergency Regulation 3701 will result in no other direct or indirect cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the GC, no other non-discretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State of California.

EFFECTIVE PERIOD

RTC section 34013, subdivision (d), provides that the emergency regulations adopted by the Department may remain in effect for two years from adoption. Therefore, Regulation 3701 shall

be effective immediately upon filing with the Secretary of State and shall remain in effect for two years from that date, unless the Department amends or repeals it before the expiration of the two-year period.

CONTACT PERSONS

Inquiries concerning the cannabis excise and cultivation taxes imposed by the CTL should be directed to Robert Wilke, Program Policy Specialist, by telephone at 916-445-2137 or by email at BTFD-BTC.InformationRequests@cdtfa.ca.gov.

Questions regarding the substance of Regulation 3701 should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at Bradley.Heller@cdtfa.ca.gov, or by mail at California Department of Tax and Fee Administration, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082. Mr. Wilke is the designated backup contact person to Mr. Heller.

TEXT OF EMERGENCY REGULATION 3701

(A new regulation to be added to Cal. Code Regs., tit. 18, div. 2)

Regulation 3701. Collection and Remittance of the Cannabis Excise Tax.

(a) In General. On and after January 1, 2018, a cannabis retailer shall not make a retail sale of cannabis or a cannabis product, unless the purchaser has paid the cannabis excise tax to the retailer at the time of the sale.

(b) Cannabis Retailer's Remittance to a Distributor – General. If a distributor sells or transfers cannabis or cannabis product to a cannabis retailer on or after January 1, 2018, then the retailer shall remit the cannabis excise tax due on the cannabis or cannabis product based on the average market price to the distributor that sold or transferred the cannabis or cannabis product to the retailer.

(c) Cannabis Retailer's Remittance to a Distributor – Exception.

(1) A cannabis retailer that possesses or controls cannabis or a cannabis product at 12:01 a.m. on January 1, 2018, and makes a retail sale of that cannabis or cannabis product on or after January 1, 2018, shall remit the cannabis excise tax due based on the average market price to a distributor licensed pursuant to division 10 (commencing with Section 26000) of the Business and Professions Code that the retailer purchased or acquired cannabis or cannabis product from on or after January 1, 2018. The cannabis excise tax shall be remitted by the cannabis retailer to the licensed distributor on or before the fifteenth day of the calendar month following the close of the calendar month in which the tax was collected.

(2) Upon collecting the cannabis excise tax from a cannabis retailer as set forth in subdivision (c)(1), a distributor shall provide the cannabis retailer with an invoice, receipt, or other similar document that contains all of the following:

- (A) Date of execution of the invoice, receipt, or other similar document,
- (B) Name of the distributor,
- (C) Name of the cannabis retailer,
- (D) The amount of cannabis excise tax,
- (E) The number of the seller's permit held by the cannabis retailer, and
- (F) The number of the seller's permit held by the distributor. If the distributor is not required to hold a seller's permit because the distributor makes no sales, the distributor must include a statement to that effect on the receipt in lieu of a seller's permit number.

(d) Distributor's Reporting and Remittance – General. Unless as otherwise provided in subdivision (e), a distributor shall report and remit the cannabis excise tax due in accordance with subdivision (e) of section 3700 of this chapter.

(e) Distributor's Reporting and Remittance – Exception. A distributor shall report and remit the cannabis excise tax collected from the cannabis retailer pursuant to subdivision (c) with the distributor's first return subsequent to receiving the cannabis excise tax from the cannabis retailer.

Note: Authority cited: Section 34013, Revenue and Taxation Code. Reference: Sections 34011 and 34015, Revenue and Taxation Code.